



M O V I N G T H E
AMERICAN
ECONOMY

U.S. Department of Transportation
Office of Public Affairs
Washington, D.C.
www.dot.gov/affairs/briefing.htm

Speech

LIBERALIZATION: MORE IMPORTANT THAN EVER

Remarks of
Jeffrey N. Shane
Under Secretary for Policy
U.S. Department of Transportation

13th Annual International CEO Conference
Miami, Florida
May 9, 2005

It is a great pleasure to be here once again at Bobby Booth's Annual CEO Conference. This is the seventh time that I have had the privilege of addressing this important gathering about developments in the ever-changing aviation industry and, as always, I am grateful to Bobby for the gracious invitation. I always look forward to these meetings. I leave this conference each year with a greater understanding and appreciation of the contributions you and your organizations make to international aviation, and to the growth of economies throughout the hemisphere.

The CEO Conference provides an invaluable opportunity for aviation industry leaders in Latin America to exchange ideas about the ways in which industry can pursue commercial development and economic liberalization within regional and global markets. It is also a conference in which industry leaders in Latin America can compare notes with counterparts in North America and other regions. In order to maximize the potential of aviation markets everywhere, it is increasingly important that decision-makers stay in touch with developments elsewhere, partaking of best practices, and addressing developments in a proactive manner.

I bring you heartfelt greetings from my boss, Secretary of Transportation Norm Mineta, who sends his warmest wishes for another successful conference. Under Secretary Mineta's leadership, we are working on a variety of important international aviation initiatives. We actively seek ways in which to improve international aviation safety, regulatory standardization, and technology. We support the efforts of our Open Skies partners to derive maximum economic benefit from our liberalized agreements; and we seek to expand the liberalization of aviation regimes through bilateral and multilateral negotiations. These are the issues I want to discuss with you this morning.

International Aviation Liberalization

Global transportation networks are the glue that holds the world's economy together, and international aviation in particular provides the critical link between economies on a global scale. Indeed, transportation has embedded itself in the very fabric of the global economy in ways we have never seen before. While the ocean and surface modes still carry the highest *volume* of goods in global trade, the aviation industry transports 40 percent of global exports by *value*. The introduction of A-380 freighter aircraft can be expected to reduce unit costs and increase further the share of cargo moving by air.

Despite the best efforts of the U.S. and other market-oriented governments, however, restrictive bilateral agreements continue to impede the international aviation industry's ability to respond fully to the demands of international business, to the detriment of economies everywhere. That's why the U.S. continues to believe that liberalization is essential to the realization of air transportation's proper place in the global economy, and critical to maximizing the contribution of aviation to global economic growth. And that's why the pursuit of Open Skies agreements remains the keystone of U.S. international aviation policy.

In the past four years, the Bush Administration has entered into 15 Open Skies agreements with nations across the globe. In July 2004, we reached an agreement with China that will provide for a nearly five-fold increase in weekly flights between our countries once the phase-in process is complete in 2010, resulting in a total of 249 weekly flights. We have estimated that a single new daily B-777 roundtrip between the U.S. and China will produce a \$158 million total annual benefit to the U.S. economy. We treat this as only a partial victory, however, because it is only through Open Skies that we can unlock the full economic potential of international aviation. Still, the 2004 U.S.-China Protocol is an important step in the right direction.

We have taken additional steps in recent months. During a recent, highly successful trip to four Asian nations, Secretary Mineta signed an Open Skies agreement with India that has already generated a proposed expansion of services between our two countries for the first time in many years. He also reached an agreement with leaders in Thailand and Hong Kong to renew bilateral negotiations and to seek a basis for further liberalization in those markets.

We continue to look for opportunities to engage our aviation partners in *this* hemisphere in an effort to expand our aviation relationships in a mutually beneficial manner. Since I last spoke here, we have engaged in a number of informal, high-level conversations with our counterparts in Mexico. We are optimistic that, through our continuing, high-level dialogue, we can modify that agreement in such a way that it better reflects the close and comprehensive relationship that we have with Mexico.

Our efforts to liberalize aviation in this hemisphere have resulted in Open Skies agreements with our Central American neighbors. Also, we continue to work with countries in the Caribbean to explore the possibility of Open Skies and its mutual benefits.

We have also had success in liberalizing aviation agreements in South America. We were pleased to conclude an Open Skies agreement with Uruguay last fall; and proud to have signed an Open Skies agreement with Paraguay just last week. Colombia and the U.S. are exploring the possibility of establishing all-cargo Open Skies in the near future.

As we continue to look for opportunities to roll back restrictions on international service with our closest neighbors through bilateral relations, we also want to reach beyond the bilateral framework and bring entire regions together under a single, liberalized agreement. The MALIAT – the Multilateral Agreement on the Liberalization of International Air Transportation – is a useful model for this sort of international relationship. The MALIAT – to which both Chile and the United States are signatories – provides benefits exponentially because new signatory nations can achieve Open Skies relations with all other MALIAT signatories with the stroke of a pen. The MALIAT also eliminates many of the standard restrictions associated with bilateral agreements. The elimination of standard bilateral ownership provisions, for example, is one way that the MALIAT effectively provides signatories with new investment opportunities.

Through Open Skies agreements – whether bilateral or multilateral -- carriers have been able to expand into new markets, as more vigorous competition stimulates new demand. They have created markets – both for business and for tourism. Carriers have been able to form cross-border alliances and thereby to extend their own networks and leverage the resulting economies of scale. Open Skies, in short, encourages change, growth, and prosperity.

U.S.-EU Aviation Relations

It is useful in this context to consider the efforts of the U.S. and the EU to create a different aviation relationship across the North Atlantic. The U.S. is continuing to work with the European Commission to forge an aviation agreement that would encompass the U.S. and all twenty-five members of the expanded European Union. If our efforts are successful, we will together create the largest fully liberalized aviation market in the world – one that embraces 26 countries, more than 700 million people, and trillions of dollars in annual trade.

As everyone here probably knows -- there has been no lack of media coverage -- the U.S. and the EU Commission, after several meetings, agreed to a package last June that the negotiators on both sides felt was a major step forward in bringing about a fully liberalized common aviation area across the North Atlantic. The EU Council of Ministers rejected the package, however, and so we are now consulting with the Commission on the parameters and timing of a renewed effort to bring the two sides together.

Under our current bilateral relationships, every U.S. carrier can serve –with a few well-known exceptions - every point in Europe from any point in the U.S. Carriers in Europe, however, can only serve U.S. cities from their country of nationality. In other words, at the present time, *no* EU carrier has the ability under the current bilateral agreements to do what *every* U.S. carrier can do: connect any point in the U.S. to any point in Europe for any purpose – combination or cargo. The reason for this disparity in respective

opportunities, of course, is the famous nationality clause that appears in every bilateral agreement – even in Open Skies agreements.

Late in 2002, the European Court of Justice ruled on the Commission's lawsuit against a number of EU Open Skies countries; ordering the Member States in question to eliminate the nationality provision from their bilateral agreements because it is inconsistent with the Treaty of Rome. The problem with the clause, quite simply, is that by reserving U.K. gateways to U.K. airlines, German gateways to German carriers, etc., it prevented EU carriers from competing with each other on international flights from EU gateways.

The U.S. read the decision and determined that we could help. We went to Brussels and offered to recognize the carriers of EU member states as "EU" carriers, as opposed to "national" carriers. All we asked in return was an Open Skies agreement covering all 25 EU member states. Because 15 of the 25 already have Open Skies agreements with us, the U.S. "ask" was to add the remaining ten countries to the Open Skies family.

Recognition of the airlines of Europe as "EU" carriers – able to fly to the U.S. from any gateway within the EU -- would eliminate, at a single stroke, the entire morass of nationality-based restrictions that limit the scope of every EU airline's operations. It would bring Open Skies opportunities in the U.S. to every EU airline not already benefiting from an Open Skies regime. And, by eliminating current bilateral ownership and control restrictions, it would facilitate for the first time a reorganization of the EU airline industry's structure. It would mean, of course, that U.S. carriers would face far more robust competition at every EU gateway city.

The problem we had in bringing an agreement to fruition, I think, is that the United States' willingness to treat all EU airlines as eligible to fly to the U.S. from anywhere in the EU – an immense concession of incalculable value to the EU side -- was barely discussed at the table. We gave that one away right up front, because we knew it was the *sine qua non* to having an agreement with the EU. We did not anticipate that our Commission counterparts would quietly pocket the most transformational success in the history of international aviation negotiations and engage us, instead, in a struggle over the right of establishment and cabotage. Those issues are necessarily issues for the longer term – requiring our Congress to revisit laws that have been on the books for a great many decades. They should not be permitted to inhibit an agreement as important as the one that the U.S. and the EU can do right now.

Regarding the controversial issue of opening up domestic aviation markets more fully to foreign investors, many in the U.S. believe that it may be time to look more closely at the issue. Some forward-looking leaders within the U.S. airline industry – like United's chairman, Glenn Tilton – have said that the restrictions have outlived their usefulness, and that they actually impede the more effective global presence that some U.S. airlines seek. I have no doubt that a serious re-examination of the issue within the U.S. is not far off. All I am saying is that that re-examination is no reason to postpone our enjoyment of the significant improvements in the framework for trans-Atlantic air services that are available to us right now.

The agreement we can do right now would be good for airlines – especially EU airlines -- and good for consumers. For that reason, we will continue to work with our trans-Atlantic partners to find the basis for achieving an agreement that works well for everyone.

Developments in Latin America

It is instructive to consider the work we are doing with our trans-Atlantic partners as we think about U.S. aviation relations with our partners throughout Latin America. Despite the important benefits that would flow to airlines from the kind of regime sought by the U.S. and the EU, no similar multilateral discussions are underway within our own hemisphere.

In spite of all the innovation taking place among airlines in the region – including new cross-border alliances, marketing relationships, and other forward-looking measures, aviation relationships between Latin American nations themselves, and between the United States and most of its Latin American aviation partners, remain burdened with nationality restrictions, designation restrictions, frequency restrictions, and restrictions on points of service, and prices. Restrictions of that kind constrain the business options that you and your companies are able to pursue in ways that seem increasingly anachronistic. In practical terms, these restrictions mean that when a new city seeks air service to the United States in order to develop tourism or manufacturing, or simply to respond to an economic cycle, it may find that airlines already use all available designations, or all allocated flights, to serve proven markets.

Given the financial difficulties of many airlines worldwide, including many in the U.S., we understand the instinct to restrict market access. It is the wrong instinct. For international air carriers to prosper in the longer term, they simply must have a liberalized relationship with the rest of the world. Restrictions that may at one point have protected Latin American airlines now serve – quite simply -- as roadblocks to their potential development.

Core tenets of the Open Skies model include unrestricted access to international markets, unrestricted entry, wholly discretionary pricing of services in response to competitive market forces, no capacity controls, and the possibility of cooperative service arrangements – all of which spur development in the aviation industry. We have seen the economic development made possible, in part, by Open Skies agreements with Costa Rica, Honduras, and Nicaragua. The flexibility to immediately implement and increase air carrier service to Costa Rica in response to tourist demand has helped spur tourist industry development in the Guanacaste province, especially around the Liberia airport. Roatan, in Honduras, now has direct service from the United States, and tourists are beginning to travel to Nicaragua.

In another significant development in relations between the United States and Central America, the U.S. has responded positively to a proposal by Grupo TACA. On January 25th of this year, the Department of Transportation issued a final order granting the carriers from all six Central American nations involved in Grupo TACA the authority to use a common trade name and a common designator code. This success was made

possible, in large part, by the liberalized Open Skies bilateral agreements established with the home nations of the Grupo TACA carriers, and realizes an aspiration first espoused by Grupo TACA's great and visionary leader, the late Federico Bloch.

Chile has been at the forefront of liberalization, a charter member of the MALIAT, and a tireless proponent of Open Skies. LAN has seen the benefits of aviation liberalization as an innovative regional airline. In fact, LAN, along with LAN Peru and LAN Express, recently filed an application similar to that of Grupo TACA -- seeking authority to use a common trade name and a common designator code. I cannot discuss the merits of the case while it is still pending, but I did want to highlight the application as another example of the kind of innovation that Open Skies can facilitate.

I began this brief discussion of U.S. aviation relationships with Latin American countries by referring to the U.S.-EU talks. What motivates the U.S.-EU talks is a far-reaching vision of what might be possible in a multilateral framework -- both in terms of air services and industry structure. There is scope for similar thinking within the hemisphere. The U.S. continues to be interested -- as I have said in past appearances in this forum -- in engaging our Latin American trading partners in a bolder, more exciting vision of how airlines should be empowered to serve our economies, and how a far wider array of market opportunities might be made available to them. Latin America has always been a crucible for innovation. The LAN and TACA groups both provide forward-looking examples of cross-border equity alliances, and it is interesting to consider what a more contemporary, more regional framework for the conduct of air services might mean for alliances of this kind. In short, it is time to think regionally, and the U.S. will be ready when you are.

Safety

Let me close with a few words about air safety. Like aeronautical authorities throughout the region, DOT treats the promotion of safety as its top aviation priority. Few are aware, however, of some of the important steps that we are taking to enhance the quality of safety management around the world. One of the most compelling reasons for moving forward together on safety initiatives is the growing level of aviation traffic in our hemisphere. The number of passengers flying between Latin America and the United States has tripled in the past twenty years. The traveling public is looking to us to find ways to improve safety so that the level of passenger traffic and trade continues to flourish.

We may best meet the challenge of improving safety by adopting a global mentality, not just looking for answers within our own individual airspaces, and by developing a wide range of compatible technologies and regulations. One emerging safety issue is the regulatory treatment of international fractional ownership operations, which are growing in popularity. We are currently working with our Canadian and Mexican counterparts, and separately with Europe, to ensure the safety of fractional ownership operations through the development of a common, consistent regulatory approach to these international operations. Through easing the burdens of differing regulatory treatment from different regulatory agencies, we hope to make certain that this increasingly popular

form of airplane ownership can grow, without sacrificing vigorous and effective safety oversight in the process.

Economic efficiency can accompany increased levels of safety. Currently, we are working through the North American Aviation Trilateral – known as the NAAT – with our partners in Canada and Mexico to harmonize standards for Required Navigation Performance or “RNP” and Area Navigation or “RNAV” programs. These programs assist pilots in accurate navigation and landing, among other things.

As FAA Administrator Marion Blakey recently pointed out at a conference in Chile, U.S. carriers report that RNP saves millions of dollars because of improved routings, especially in areas where rough terrain and brutal weather conditions make arrivals and navigation difficult. These innovations, along with President Bush’s policy to continue to provide GPS services worldwide -- free of direct user fees for civil, commercial and scientific uses – will lead to an efficient and seamless operating environment. All of us will be the beneficiaries.

Conclusion

As the world marches on, and as international aviation grows ever more critical to the functioning of the global economy, the need to modernize the diplomatic and legal arrangements that govern these essential services has become ever more compelling. You may rest assured that the U.S., for its part, will continue to seek liberalized agreements wherever we can find them – and will continue to engage our trading partners on aviation matters large and small. We will continue to plan for the future of aviation, and, of course, we will continue to insist that the safety of that system remains second to none.

Thank you for listening. I look forward to your questions.

###